amicus curiae.[1] As appears from their respective briefs, petitioner and the SEC differ with one another in substantial respects. While the SEC has limited itself to the question of the existence of federal jurisdiction in respect of the sale by Manhattan of certain government bonds, the proceeds of which were allegedly misappropriated, petitioner relies additionally upon (a) the purchase of Manhattan's stock by the defendant James F. Begole and (b) certain transactions involving certificates of deposit. As to Bankers Life, there is not to be found in the complaint or the comprehensive pre-trial discovery record a single factual allegation of wrongdoing in respect of any of the transactions relied upon by petitioner or the SEC. This brief, nevertheless, will demonstrate that petitioner has failed to state a claim maintainable under the federal securities laws and that the petitioner and the SEC have mistakenly challenged the decision below.

Questions Presented

1. May petitioner, as liquidator of Manhattan, maintain an action on Manhattan's behalf based upon alleged fraudulent transactions authorized and approved by Manhattan's sole stockholder?

2. Where the representative of a corporation purporting to sue for fraud under the federal securities laws fails to allege or show any manipulation of any securities market or other abuse of the trading process or any injury to any investor in, or shareholder of, the corporation, has a federal claim been stated?

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1. References to pages of petitioner's brief appear herein as "(pet. br.)" and to pages of the SEC's brief as "(SEC br.)."

3. Where in respect of one of multiple defendants, the record fails to disclose any basis for claiming any federal wrong and diversity of citizenship is absent, does federal jurisdiction exist in respect of such a defendant?

Counterstatement of the Case

Petitioner commenced this action in August 1963, more than one and one-half years after Bankers Life, in January 1962, had sold all the stock of Manhattan to defendant Begole (now deceased). Immediately after the commencement of the action, when the deposition upon oral examination of petitioner was taken, it became apparent that there was no factual basis upon which to have made Bankers Life a party to the action. Acknowledgment by petitioner of this unusual but significant circumstance was coupled with his claim that he required an opportunity to conduct discovery proceedings. (Tr. of petitioner's deposition, pp. 66-68, Oct. 8, 1963) Four and one-half years later, after approximately 40 witnesses had been examined and the discovery record consisted of some 12,000 pages of transcript with approximately 500 exhibits, it was clear, as it had been at the outset, that there was no proper basis upon which to retain Bankers Life as a party to the action.

The motion of Bankers Life to dismiss for lack of federal jurisdiction, granted by the United States District Court for the Southern District of New York, grew out of a prior motion by Bankers Life for summary judgment dismissing the complaint as to it on the ground (a) that there is no genuine issue as to any material fact and (b) that said defendant is entitled to judgment as a matter of law.

On June 19, 1968, the district court (Ryan, J.) entered an order denying the summary judgment motion "not

on the merits and without prejudice." (A 41a)[2] The court ruled that it was powerless to act upon the motion until petitioner's questionable claim of federal jurisdiction was determined.[3] (A 44a)

Accordingly, Bankers Life moved for an order granting judgment on the pleadings dismissing the complaint pursuant to Rules 12(c) and (h) of the Federal Rules of Civil Procedure. That motion was argued before the district court (Herlands, J.) on September 10, 1968, together with a similar motion made by respondents Belgian American Banking Corporation and Belgian American Bank & Trust Company. Corresponding motions made by respondents Irving Trust Company, Garvin, Bantel & Company and George K. Garvin were heard before Judge Ryan. At the court's discretion, the four motions were not consolidated.

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2. References to pages of the Appendix appear herein as "(A)".

3. When petitioner initiated this action in August 1963, he alleged in his complaint, as the sole jurisdictional basis for the action, "violations of Section 17A of the Securities Act of 1933 (U.S.C.A. § 77q(a))." (A 4a, ¶ 1) In a word, the sole claim of petitioner was that Manhattan was a defrauded purchaser of its own stock. Commencing with the respondents' answers to the complaint (A 14a-39a), and from time to time thereafter, petitioner was repeatedly put on notice of the lack of federal jurisdiction. Nevertheless, in August 1967, when petitioner represented he had completed all of his pre-trial discovery and declared his readiness for trial by filing the required Note of Issue, he again unqualifiedly stated therein that "a violation of Section 17(a) of the Securities Act of 1933" was the jurisdictional basis for the action.

Even after Judge Ryan in his June 19, 1968 order had specifically questioned the existence of federal jurisdiction, petitioner served a 59-page "Preliminary Pre-Trial Memorandum" and, in it, again expressly set forth petitioner's sole basis for federal jurisdiction as follows (pp. 1-2):

"A. JURISDICTION

This action is based on Section 17A of the Securities Act of 1933 (15 U.S.C.A. 77q(a)). The Court has jurisdiction under Section 22(a) of the same Act (15 U.S.C.A. 77(v))."

At no time since the action had been commenced in August 1963 had petitioner even remotely claimed any basis for federal jurisdiction other than Section 17(a) of the 1933 Act. Only when faced with the jurisdictional motions in the district court in 1968 did petitioner suddenly and for the first time contend that he was entitled to rely on some other federal statute – – and seized upon Section 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. § 78j(b)) and Rule 10b-5 promulgated thereunder (17 C. F. R. 240.10b-5). In short, petitioner sought refuge in a new contention that if he could not sustain federal jurisdiction under Section 17(a) of the 1933 Act by claiming that Manhattan was a defrauded purchaser of its own stock, he might be able to do so under Section 10(b) of the 1934 Act by claiming that Manhattan, as a seller of government bonds, had been defrauded because defendant Begole and others had misappropriated the proceeds of the sale of those government bonds.

In opposing the motions to dismiss, the courts below permitted petitioner to draw upon the entire pre-trial discovery record and to present his case on the basis of both Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act. After full consideration of the issues raised in light of both sections, the courts below found that neither of them covered petitioner's claim. In a searching and exhaustive opinion dated June 3, 1969, Judge Herlands granted the two motions which were before him (A. 50a), and on June 9, 1969 Judge Ryan granted the two motions which were before him. (A 89a) Judgments were entered upon the decisions of Judges Herlands and Ryan, and upon petitioner's appeal from those judgments, the Court of Appeals for the Second Circuit affirmed. (A 97a) Petitioner's petition for rehearing and suggestion for rehearing *en banc* were denied on September 30, 1970. (A 112a, 113a)

The essence of petitioner's claim is corporate waste and mismanagement in that the defendant, the late James Begole, the purchaser of all of the stock of Manhattan on January 24, 1962, engaged in a scheme, with others, to deplete the assets of Manhattan and to conceal these facts from the Superintendent of Insurance of the State of New York by a complex series of transactions. Upon the basis of the entire record, Judge Herlands stated:

> "The complaint in this case presents no more than a complicated scheme of common law fraud." (A 88a)

Judge Herlands also stated:

> "Discovery herein has been extensive. The parties have not called to the Court's attention any facts which were not alleged in the complaint and which would, if leave to amend the complaint were granted, state a cause of action under the securities acts." (A 88a)

While petitioner, prior to the motions to dismiss for lack of federal jurisdiction, had numerous opportunities to seek amendment of his complaint, he did not do so. Instead, apparently aware of the futility of amendment and the inapplicability of the federal securities laws, petitioner, in 1965, commenced an action in the Supreme Court of the State of New York against the same defendants alleging the identical transactions and seeking the identical relief sought here.[4] (A 124a) The state court action is still pending.

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4. New York Civil Practice Law and Rules, Rule 3117(c), provides in part: "When an action has been brought in any court of any state or of the United States and another action involving the same subject matter is afterward brought between the same parties or their representatives or successors in interest all depositions taken in the former action may be used in the latter as if taken therein."

Judge Ryan, in granting the motions before him, stated that dismissal of the complaint was "without prejudice to prosecution of the action plaintiff filed and is pending in the Supreme Court, County of New York." (A 90a) He expressed full agreement with the opinion of Judge Herlands and also found that the "fraud alleged was not in the purchase or sale of securities, but was waste of Manhattan's assets by diversion and misappropriation of its securities." (A 89a) He further agreed "with Judge Herlands that 'the complaint in this case presents no more than a complicated scheme of common law fraud' over which there is no independent federal jurisdiction." (A 89a)

In affirming the decisions of the district court, the court of appeals found that there had not been any manipulation of any securities market or other abuse of the trading process; that no investor in, or shareholder of, Manhattan had suffered injury; and therefore, that a federal claim had not been stated. (A 107a) As will hereinafter appear, there was no occasion to consider, and, as the court of appeals stated, it did not decide that creditors of Manhattan "do not have any remedy under general state tort law for the fraud practiced on their debtor, but only that the federal Securities Acts have not provided a federal forum for its enforcement." (A 107a)

Argument

Point I

Petitioner has failed to allege, or show any facts in support of, any claim against Bankers Life; federal jurisdiction does not exist as to it.

Petitioner's statement of "The Facts" is virtually devoid of any references to the allegations of the complaint or any portion of the pre-trial discovery record. (pet. br.

6-12) Petitioner presents questions for review based, in large part, upon imagined circumstances and speculative conclusions which have not been pleaded and cannot be supported by the discovery record. The haphazard character of petitioner's "Facts" is exemplified by the reckless use of inflammatory references to "perpetrators" and "schemers", though the discovery record shows that Bankers Life perpetrated nothing and had no connection whatsoever with any scheme.[5]

The complaint (A 4a) consists of 40 paragraphs, most of which have nothing whatsoever to do with Bankers Life. As to Bankers Life, the complaint alleges no more than that it is an Illinois corporation (¶ 3); that it owned all of the capital stock of Manhattan prior to January 24, 1962 (¶ 17); that negotiations for the sale of said stock had been carried on for a period of approximately three months, between November 1961 and January 19, 1962 (¶ 19); that on January 19, 1962, a contract for the sale of said stock was entered into between Bankers Life, as seller, and defendant James Begole, as purchaser (¶ 20); that said contract provided for a price to be paid Bankers Life of $5,000,000 by bank or certified check which was to be delivered at the closing on January 24, 1962 (¶ 20); that on

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5. Petitioner's inaccurate statement of "The Facts" apparently has led the SEC astray. Thus, for example, the SEC, apparently unfamiliar with the factual distinctions of record between Bankers Life and other defendants, erroneously lumps defendants together in instances such as the following: (a) "with the aid of *the other named defendants,* they [the purchasers of the Manhattan stock] embarked upon a scheme to use Manhattan's own assets to pay for the purchase of its stock." (SEC br. 5) (emphasis added); (b) "fraudulent conduct for which *any or all of the respondents* can be held responsible" (SEC br. 12) (emphasis added); and (c) "failure of *the defendants* to disclose their intention to misappropriate the proceeds". (SEC br. 21) (emphasis added)

The cavalier technique thus employed in bandying about generalized references to "defendants" and "respondents" is incompatible with the fully developed discovery record.

the morning of January 24, 1962, at the closing, there was delivered to Bankers Life a check of Irving Trust Company in the amount of $5,000,000 (¶ 26).

The complaint then refers to events which allegedly occurred later in the day of January 24, 1962 (¶¶ 27-30) and thereafter (¶¶ 31-39), but none of those allegations make any reference to Bankers Life. Thus, each of the alleged frauds, namely the alleged frauds involving (a) the purchase by defendant Begole of all of the Manhattan stock, (b) the subsequent sale of Manhattan's government bonds, and (c) the purchase of certificates of deposit, concern defendants other than Bankers Life.

The absence of any connection of Bankers Life to the alleged frauds was confirmed by petitioner's attorney, who, in describing the complaint in open court, stated:

> "Thereafter, the complaint alleges that defendants, other than Mr. Parker's client [Bankers Life] entered into a scheme to cover up this depletion of the corporate assets which was successful for about a year and a half." (Tr. of petitioner's deposition, p. 196, Nov. 6, 1963)

The complaint did not allege, and discovery failed to disclose, any connection between Bankers Life and the frauds alleged.

In June 1968, after petitioner had concluded all pretrial discovery and represented to the district court that he was prepared to proceed to trial, Judge Ryan entered his order with respect to the summary judgment motion of Bankers Life in which he stated:

> "Nowhere is it charged that the negotiations for the raising of the purchase price were participated in by BANKERS LIFE or even that it had any knowledge of them." (A 42a)

In connection with the subsequent motions to dismiss for lack of federal jurisdiction, Judge Herlands, upon the basis of the complaint and the entire pre-trial discovery record, also found that there was no charge in any respect that any information was either improperly disclosed or withheld in respect of the contract for the purchase and sale of Manhattan's stock. Thus, as Judge Herlands wrote:

> "The complaint does not charge that any misrepresentations, deceit or non-disclosures had been made or practiced upon any party in connection with this contract of purchase and sale." (A 52a)

As so clearly appears from the briefs of the petitioner and the SEC, they are principally concerned with the sale of Manhattan's government bonds with which Bankers Life had no connection whatsoever. Thus, the transactions complained of as the basis of the alleged fraud relate to defendants other than Bankers Life. As the court of appeals correctly observed:

> "In this lawsuit our attention has been shifted away from that conventional purchase and sale of the Manhattan stock to the legerdemain employed by the buyer to obtain the $5,000,000 with which to pay for the stock." (A 98a-99a)

Confirming the total absence of any connection between Bankers Life and the buyer's activities in raising the funds to pay for Manhattan's stock by misappropriating Manhattan's assets, petitioner argues (br. 16 *et. seq.*) that it was the buyer's board of directors which was misled in connection with the sale of Manhattan's government bonds after Manhattan's sole stockholder-purchaser had acquired control of Manhattan.[6]

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6. The following appears in petitioner's brief:
"A. § 10(b) and Rule 10b-5 are Violated When a Board of Directors is Fraudulently Induced to Author-

Since no claim has been — — nor, on the basis of the discovery record, can be — — alleged against Bankers Life, it is clear that no federal jurisdiction exists as to it. And this fact certainly cannot be altered by any interpretation of the legislation which this Court is called upon to review. Bankers Life is simply not involved in the argument of petitioner and the SEC whether there were schemes or devices employed by others in connection with the sale of Manhattan's government bonds or the transactions relating to the various certificates of deposit. Accordingly, in no respect can Section 17(a) of the 1933 Act or Section 10(b) of the 1934 Act serve as the basis of any claim against Bankers Life; dismissal of the complaint was unquestionably correct as to Bankers Life.

Point II

Petitioner, as liquidator of Manhattan, cannot maintain an action on behalf of Manhattan based upon the alleged fraud of Manhattan's sole stockholder; moreover, there is no allegation or showing of any injury to any party entitled to protection of the federal securities laws and, accordingly, federal jurisdiction does not exist over the subject matter of this action.

The complaint, fully supplemented by the comprehensive discovery record, does not state a claim cognizable under the federal securities laws.

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ize the Sale of Securities of a Corporation." (pet. br. 17)

"B. § 10(b) and Rule 10b-5 are Violated When the Proceeds From a Sale of Securities are Misappropriated." (pet. br. 24)

Similarly, the SEC states:

"[I]f petitioner cannot prove fraud with respect to the sale of those bonds, he also could not recover under his two other theories." (SEC br. 7n.6)

A. Petitioner, as liquidator of Manhattan, cannot maintain an action on behalf of Manhattan based upon the alleged fraud of Manhattan's sole stockholder.

Petitioner contends that the alleged fraud of the sole stockholder of Manhattan in misappropriating its assets is actionable and that petitioner is entitled to maintain an action by reason thereof. The contention thus made is erroneous for the following reasons:

1. The corporation has no right to maintain an action based upon the alleged fraud of its sole stockholder who authorized and approved all of the transactions relating to the alleged fraud. See *Field* v. *Lew,* 184 F.Supp. 23, 27 (E.D.N.Y. 1960), *aff'd,* 296 F.2d 109 (2d Cir. 1961), *cert. denied,* 369 U.S. 859 (1962); *General Hatters Supply Co.* v. *Hartman,* 148 N.Y.S.2d 90 (Sup. Ct. N.Y. Co. 1955).

2. Since the corporation may not maintain an action based upon the alleged fraud of its sole stockholder, petitioner, who is the corporation's representative, cannot maintain such an action on its behalf. See *Field* v. *Lew, supra.*

3. Since the corporation has no right of action, the fact that the alleged fraud involved the purchase or sale of securities is of no consequence. Hence, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder have no application in the circumstances here.

While creditors, if any, of Manhattan may have suffered injury as a result of the alleged fraud committed by its sole stockholder and by reason thereof may maintain an

action in the state courts, they may not assert any rights under the federal securities laws. Even if it be assumed, contrary to the record in this case, that any injured creditors exist, they are neither purchasers nor sellers of securities and, therefore, are not entitled to protection under the federal securities laws. (pp. 17-20, *infra*) It is interesting to observe that petitioner who, before the district court, vigorously argued that Manhattan's creditors had been defrauded (petitioner's memorandum served September 3, 1968, pp. 35, 42), abandoned his argument as to a fraud on creditors before the court of appeals and stands mute in this regard here.[7]

Nevertheless, even if it were assumed *arguendo* that, as the SEC contends (SEC br. 28), the federal securities laws should be expanded to include protection of creditors, this is certainly not a case in which those laws should be so judicially enlarged. A more inappropriate case for the interpretation sought by the SEC can hardly be imagined. Upon the record here, the SEC has no basis to argue hypothetically as if there were creditors who were injured or to seek, in this case, expansion of the federal securities laws to cover such hypothetical creditors. The comprehensive discovery record before this Court is devoid of any facts showing any injury to any creditor, or even the existence of any creditor of Manhattan.[8]

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7. Significantly, in the course of pre-trial discovery, petitioner had flatly asserted that any inquiry as to who might have suffered damages and the amount thereof, if any, was totally irrelevant to the issues in this action. (affid. of M. P. Unger, October 11, 1967, p. 7)

8. For the same reason, *Bailes* v. *Colonial Press, Inc.*, No. 29048 (5th Cir. June 15, 1971), which was decided after the briefs of petitioner and the SEC were served, is inapposite in spite of its apparent unique extension of Rule 10b-5 for the benefit of a corporation's creditors. (p. 16, *infra*)

B. Petitioner and the SEC have misconstrued the reasoning of the court of appeals and overlooked the fact that in reaching its decision the court below correctly interpreted and applied the legislative purposes of the federal securities laws; furthermore, there is no allegation or showing of any injury to any person entitled to protection of the federal securities laws.

Both petitioner and the SEC not only have failed to recognize that petitioner, as the representative of Manhattan, has no federal right of action, but their principal arguments presented in criticism of the decisions below do not fairly reflect the careful attention which those courts gave to the purposes of the federal securities laws.

Thus, the SEC, on the one hand (br. 22), makes the irrelevant charge that the court of appeals in reaching its decision attempted to "fragment the transaction by which Manhattan's securities were sold into several parts", and the petitioner, on the other hand (br. 20), erroneously asserts that the court below arrived at its decision by application of a so-called "terms of the sale test" in respect of the sale of Manhattan's government bonds. To the contrary, the court below reached decision by an analysis of the Congressional purposes, and the language, of the very provisions of the securities laws relied upon by petitioner and the SEC. The court of appeals addressed itself to the question whether the fraud alleged, in the language of Rule 10b-5, was "in connection with" (A 106a) the purchase or sale of any security.[9]

9. Similarly, Judge Herlands had shown his full awareness of the need to determine whether a fraud had been committed "in connection with" the purchase or sale of securities within the meaning of Rule 10b-5. As Judge Herlands wrote:

> ". . . the sale of Manhattan's portfolio and the purchase of the Manhattan shares were necessary steps toward the ultimate looting of Manhattan's assets. *But Rule 10b-5 requires the employment of fraud in connection with a security transaction, which is essentially different from the effectuation of a security transaction in connection with a fraudulent activity.*" (A 83a-84a) (emphasis added)

In answering that question, the court of appeals expressly recognized that the "scope of the rule must be assessed in light of the purposes of the legislation from which it derives, which we recently found to be 'to promote free and open public securities markets and to protect the investing public from suffering inequities in trading.'" (A. 106a) Though Congress undoubtedly could have expanded the securities laws to afford protection to creditors, in addition to the investing public, it did not choose to do so. As the court of appeals stated:

> "The civil liabilities provisions of the federal Securities Acts, beginning at 15 U. S. C. § 77(1) were 'part of a broad integrated program designed to obtain honest dealings in securities,' *Wilko* v. *Swan*, 127 F. Supp. 55, 58 (S. D. N. Y. 1955), not one to create an unlimited federal right of action for damages for all who have been defrauded in any area of economic activity." (A 107a)

While fiduciary obligations of controlling shareholders, upon which the SEC relies (SEC br. 28), may be enforceable by injured creditors under state law, the absence of any injury to any investor or shareholder of Manhattan renders the federal securities laws inapplicable. It is true that the allegedly misappropriated assets of Manhattan consisted of the proceeds of the sale of certain securities, but such an act of mismanagement or breach of fiduciary duty does not give rise to a right of action under the federal securities laws simply because securities are involved. *Drachman* v. *Harvey*, No. 35077 (2d Cir. July 21, 1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970); *O'Neill* v. *Maytag*, 339 F. 2d 764 (2d Cir. 1964); *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952); *Cohen* v. *Colvin*, 266 F. Supp. 677 (S.D.N.Y.

1967); *Hoover* v. *Allen,* 241 F. Supp. 213 (S. D. N. Y. 1965); *Barnett* v. *Anaconda Co.,* 238 F. Supp. 766 (S. D. N. Y. 1965); *Pettit* v. *American Stock Exchange,* 217 F. Supp. 21 (S. D. N. Y. 1963).

As was observed in *Pettit:*

> "[C]ourts have been disinclined to allow 'innumerable facets of internal corporate affairs' to be included within federal question jurisdiction on the basis of a purchase or sale of securities that is only incidental to a major mismanagement issue." 217 F. Supp. at 25.

Nevertheless, both petitioner and the SEC mistakenly argue that *any* act of corporate mismanagement or breach of a fiduciary duty having an incidental security transaction gives rise to a right of action under the securities laws even though unaccompanied by manipulation or other market or trading abuse or injury to stockholders or investors. Recently decided *Bailes* v. *Colonial Press, Inc., supra,* obviously was also ill-considered to the extent that the Fifth Circuit upheld the sufficiency of a claim under Section 10(b) and Rule 10b-5 because it alleged that those who became creditors after the alleged fraud may have been damaged as a result thereof.

The infirmity of such a position was recently commented upon in a penetrating article as follows:

> "An unrestricted application of rule 10b-5 is, however, also inconsistent with the purposes of the rule. The most liberal view, often expressed by the Commission, is that *anyone* who is damaged by a fraudulent transaction should be allowed to seek relief under 10b-5. This view would lead to almost unlimited liability. As an illustration, assume a de-

> fendant defrauds XYZ Corporation in a securities transaction, causing XYZ Corporation to go into bankruptcy. Following the SEC viewpoint, the stockholders of the corporation would be permitted to recover the loss in market value of their stock and, perhaps, even the creditors of the corporation would be permitted to recover their loan losses. Such broad coverage under section 10(b) was not the intent of Congress; the antifraud provisions were adopted to protect the trading process in the securities markets, not to provide a federal remedy for every injury that might in any way be connected with a securities fraud." Boone and McGowan, *Standing To Sue Under SEC Rule 10b-5,* 49 Texas L. Rev. 617, 622 (1971) (footnotes omitted)

In any event, apart from any interpretation of legislative intent in respect of Section 10(b) of the 1934 Act, since upon the record here no injury to any shareholder, investor or even creditor appears, it follows that the SEC has mistakenly selected this case for the purpose of seeking judicial expansion of the legislation relied upon by petitioner.

Point III

Petitioner mistakenly contends that this Court in this case should review the purchaser-seller requirement of *Birnbaum* v. *Newport Steel Corp.*; even if that requirement is reviewed, there would be no valid basis for altering the conclusion reached by the court below.

Petitioner's argument (br. 32-35) that the purchaser-seller requirement first enunciated in *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952) should be abolished need not be considered by

this Court in this case. That requirement of *Birnbaum* merely goes to the question of a party's standing to sue under the federal securities laws — a requirement which is met where the party suing is held to be a purchaser or seller of securities. Since it was held below that petitioner did have standing to sue in respect of the sale of Manhattan's government bonds (A 80a), it is an unnecessary and futile exercise for petitioner to contend also that he has standing to sue in respect of the purchase of the Manhattan stock and the later transactions relating to certificates of deposit. The court below dismissed the complaint, not because petitioner has no standing to sue, but because petitioner had failed to assert a federal claim. Even the SEC has expressly acknowledged that there is no need for this Court to concern itself in this case with the question of the abolition of *Birnbaum's* purchaser-seller requirement. (SEC br. 7n.6)

At the same time, the SEC appears to indulge in a strange dichotomy. While, on the one hand, the SEC suggests that this Court may leave undisturbed the *Birnbaum* purchaser-seller requirement (SEC br. 7n. 6), it argues, on the other hand, for expansion of Rule 10b-5 to include protection to creditors of a corporation who are neither purchasers nor sellers of its securities. (SEC br. 28). Not only is the contention of the SEC based upon an unsupported assumption that in this case creditors exist, but the contention that, in private civil suits for damages, Rule 10b-5 was intended to cover creditors of a corporation is against the overwhelming weight of authority.

With the sole possible exception of *Bailes* v. *Colonial Press, Inc., supra,* in every known case where the *Birnbaum* purchaser-seller requirement has been considered, the courts have uniformly applied that requirement in order to sustain or reject a party's standing to sue. *E.g., Iroquois Industries, Inc.* v. *Syracuse China Corp.,* 417 F.2d 963 (2d Cir.

1969), *cert. denied,* 399 U.S. 909 (1970); *Herpich* v. *Wallace, supra; Mader* v. *Armel,* 402 F.2d 158 (6th Cir. 1968), *cert. denied sub nom. Young* v. *Mader,* 394 U.S. 930 (1969); *Dasho* v. *Susquehanna Corp.,* 380 F.2d 262 (7th Cir.), *cert. denied sub nom. Bard* v. *Dasho,* 389 U.S. 977 (1967); *Erling* v. *Powell,* 429 F.2d 795 (8th Cir. 1970); *The Greater Iowa Corp.* v. *McLendon,* 378 F.2d 783 (8th Cir. 1967).

The *Birnbaum* purchaser-seller requirement has been honored by the courts for almost two decades in numerous cases presenting highly diversified fact situations. While it has been flexibly applied, it is not difficult to foresee the unnecessary flood of potential litigation in the federal courts which could follow elimination of the *Birnbaum* requirement and the SEC's proposed judicial enlargement of Rule 10b-5 by giving creditors standing to sue thereunder.

Adhering to the teaching of this Court, the court below in *Iroquois Industries, Inc.* v. *Syracuse China Corp., supra,* has warned against the judicial extension of Rule 10b-5 reflected in *Bailes, supra.* In *Iroquois,* the court wrote:

> "The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, *the protection of defrauded purchasers and sellers.* It is not the province of the courts to extend Section 10(b) to apply to transactions not intended to be covered by Congress. We do well to heed the words of Mr. Justice Black, writing for the Court in a case about another section of the 1934 Act, *Blau* v. *Lehman,* 368 U. S. 403, 413, 82 S. Ct. 451, 457, 7 L. Ed. 2d 403 (1962):
>
> > 'Congress can and might amend [the Act] if the Commission would present to it the policy arguments it has presented to us, but we think that Con-

gress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.' " 417 F. 2d at 969 (emphasis added)

While the SEC contends that the decision below will tend to impede its enforcement capabilities and raises the spectre of diminished efficacy of the anti-fraud provisions (SEC br. 9-10), there is far greater likelihood that acceptance of the position of the SEC taken here will needlessly wrest from the state courts claims which properly lie within their jurisdiction rather than the jurisdiction of the federal courts.

Point IV

The writ of certiorari should be dismissed.

It is respectfully submitted that the writ of certiorari was improvidently granted and therefore should be dismissed. Briefly stated, the reasons are these:

1. The argument of petitioner and the SEC that Manhattan was defrauded is based upon a factitious separation of the corporate legal entity from its sole beneficial owner in order to invent a mythical victim of the sole shareholder's fraud. Additionally, the SEC, but not the petitioner, makes the further untenable argument that such a claim should be maintainable for the benefit of creditors in spite of the fact that neither the complaint nor the record can support the existence of any injured creditor or the existence of any creditor at all.

2. The allegations of the complaint, together with petitioner's unsupported statement of the purported facts of this case, amount to no more than a claim of

corporate waste and mismanagement in respect of which incidental securities transactions took place. There is not even a faint implication of any manipulation or other abuse of any securities market or the trading process. There is certainly no claim—nor could there be—that any investors or shareholders have been damaged or defrauded. In fact, having failed to claim or show that any creditors have been injured by the transactions complained of, petitioner has not even alleged a fraud for which relief can be granted.

3. The *Birnbaum* purchaser-seller requirement is not properly before this Court for review. The district court expressly held, and the court of appeals assumed, that petitioner had the requisite standing to sue with respect to the sale of Manhattan's government bonds. Thus, the presentation by petitioner of the question of the abolition of the rule is a futile exercise in which the SEC has refused to join. Moreover, for almost two decades, the requirement has withstood challenge in the innumerable cases which have established its validity as a rule of law.

4. The unrestricted interpretation of the words "in connection with the purchase or sale of any security" sought by petitioner and the SEC, not only would eradicate all limits on private civil actions for damages under Section 10(b) of the 1934 Act and Rule 10b-5, but it would go far beyond the intent of Congress "to promote free and open public securities markets and to protect the investing public from suffering inequities in trading." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Coates* v. *SEC*, 394 U. S. 976 (1969). Not only do the highly individualized facts of this case render it totally in-

appropriate as a vehicle for such action, but if the unlimited interpretation of the statutory language, for which petitioner and the SEC contend, is to be adopted, it is respectfully submitted that the proper body to make such determination is Congress rather than this Court. See *Blau* v. *Lehman*, 368 U. S. 403, 413 (1962).

Conclusion

For all of the foregoing reasons, it is respectfully submitted that the question of federal jurisdiction was correctly decided by the court below; that a federal claim has not been stated; that federal jurisdiction does not exist; and that the judgment below should be affirmed or the writ of certiorari should be dismissed.

It is respectfully submitted further that, at the very least, no claim has been asserted against Bankers Life; that federal jurisdiction does not exist as to Bankers Life; and that the judgment below should be affirmed as to it.

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August 31, 1971.

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No. 70-60

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK, as Liquidator of MANHATTAN CASUALTY COMPANY,
Petitioner,

against

BANKERS LIFE AND CASUALTY COMPANY, IRVING TRUST COMPANY, BELGIAN AMERICAN BANKING CORPORATION, BELGIAN AMERICAN BANK & TRUST COMPANY, GARVIN, BANTEL & COMPANY, GEORGE K. GARVIN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IRVING TRUST COMPANY

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against

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Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IRVING TRUST COMPANY

Preliminary Statement

In the complaint Petitioner, the Liquidator of Manhattan Casualty Company ("Manhattan"), seeks judgment for $5,500,000 and alleges that the Respondents and others defrauded Manhattan in connection with the sale of all the outstanding shares of Manhattan by defendant Bankers Life and Casualty Company ("Bankers Life") to defendant James F. Begole ("Begole") in violation of Section 17(a)

of the Securities Act of 1933 (15 U.S.C. § 77q(a)). Named as defendants, in addition to the Respondents, were Begole, New England Note Corporation ("New England"),[1] John F. Sweeny ("Sweeny") and Standish T. Bourne ("Bourne"). As a result of the alleged fraud defendant Begole became the sole shareholder of Manhattan.

In 1965, in the midst of extensive pretrial discovery and in apparent recognition of the absence of federal jurisdiction, Petitioner commenced an action—still pending—in the Supreme Court of the State of New York against the same defendants, alleging virtually the same facts and seeking relief under state law identical to the relief sought in this action. (The complaint in the New York State action appears in the Appendix at pages 124a-141a.)

In an Order dated June 19, 1968, the District Court (Hon. Sylvester J. Ryan) questioned its jurisdiction over the subject matter of this action and indicated the need for resolution of that issue. (App., p. 40a) Respondents Bankers Life, Belgian American Banking Corporation ("Belgian Banking") and Belgian American Bank & Trust Company ("Belgian Trust") thereupon moved before Hon. William B. Herlands to dismiss the complaint under Rules 12(c) and 12(h) of the Federal Rules of Civil Procedure on the grounds that the District Court lacked subject matter jurisdiction and the complaint failed to state a claim under federal law. Respondents Irving Trust Company ("Irving"), Garvin, Bantel & Company ("Garvin, Bantel") and George K. Garvin ("Garvin") thereafter moved before Hon. Sylvester J. Ryan for the same relief.

On June 3, 1969, Judge Herlands filed his opinion granting the motions of Respondents Bankers Life, Belgian Banking and Belgian Trust. (App., p. 50a) On June 9,

1. New England Note Corporation was formerly named New England Acceptance Co., Inc. This corporation is hereinafter referred to as "New England".

1969, Judge Ryan filed his opinion granting the motions of Respondents Irving, Garvin, Bantel and Garvin. (App., p. 91a)

On July 22, 1970, the Court of Appeals for the Second Circuit affirmed the judgments of Judge Herlands and Judge Ryan dismissing the complaint. (App., p. 97a) Petitioner's petition for rehearing and suggestion for rehearing *en banc* were denied on September 30, 1970. (App., pp. 112a, 113a)

In opposing Respondents' jurisdictional motions and in connection with his application for leave to amend the complaint, Petitioner resorted to use of the entire record accumulated during the more than four years of pretrial discovery. Judge Herlands considered the motions to dismiss on the basis of the allegations of the complaint, the additional facts presented in Petitioner's brief and Petitioner's "amendatory allegations presented in open court." (App., p. 76a; see also App. pp. 52a and 66a) After a comprehensive analysis of all the facts presented by Petitioner, Judge Herlands concluded that the "complaint in this case presents no more than a complicated scheme of common law fraud" and held that there was no federal jurisdiction under either Section 17(a) of the Securities Act of 1933 or Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)). (App., p. 88a)

Judge Ryan, in granting the motions before him, expressed full agreement with the opinion of Judge Herlands and also found that the "fraud alleged was not in the purchase or sale of securities, but was waste of Manhattan's assets by diversion and misappropriation of its securities." He further agreed "with Judge Herlands that 'the complaint in this case presents no more than a complicated scheme of common law fraud' over which there is no independent federal jurisdiction." (App., p. 89a) Judge Ryan expressly stated that the dismissal of the complaint was